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High Yield Municipal Bonds: An Attractive Choice for Risk-Adjusted Return

For high yield corporate bond investors seeking an attractive investment to complement their portfolios, high yield municipal bonds feature a number of compelling characteristics.

Key Takeaways

- While this discussion focuses on high yield municipal bonds, we believe they can also serve as a complementary allocation alongside taxable high yield within a broader fixed income portfolio, particularly for investors seeking to optimize after-tax income.
- Historically, high yield municipal bonds have defaulted at about one-fourth of the rate of their corporate counterparts. When municipals have defaulted, investors have realized greater recovery rates than those for corporate bonds.
- Given those factors, we believe high yield munis offer compelling value on a tax-equivalent basis when returns are adjusted to reflect the impact of taxes.
- Further, risk-adjusted returns for high yield munis (when adjusted for municipal bonds' tax-free income) are higher than high yield corporates and virtually all of the major fixed income sectors.
- Based on their larger risk premium, high yield municipal bonds offer an opportunity for high-earning investors to capture enhanced income and risk-adjusted returns while potentially benefiting from munis' inherent tax advantages.

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Lord Abbett

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